No. 956

In the Supreme Court of the United States

October Term, 1943

W. P. Burnet, Collector of Internal Revenue for the State of South Carolina

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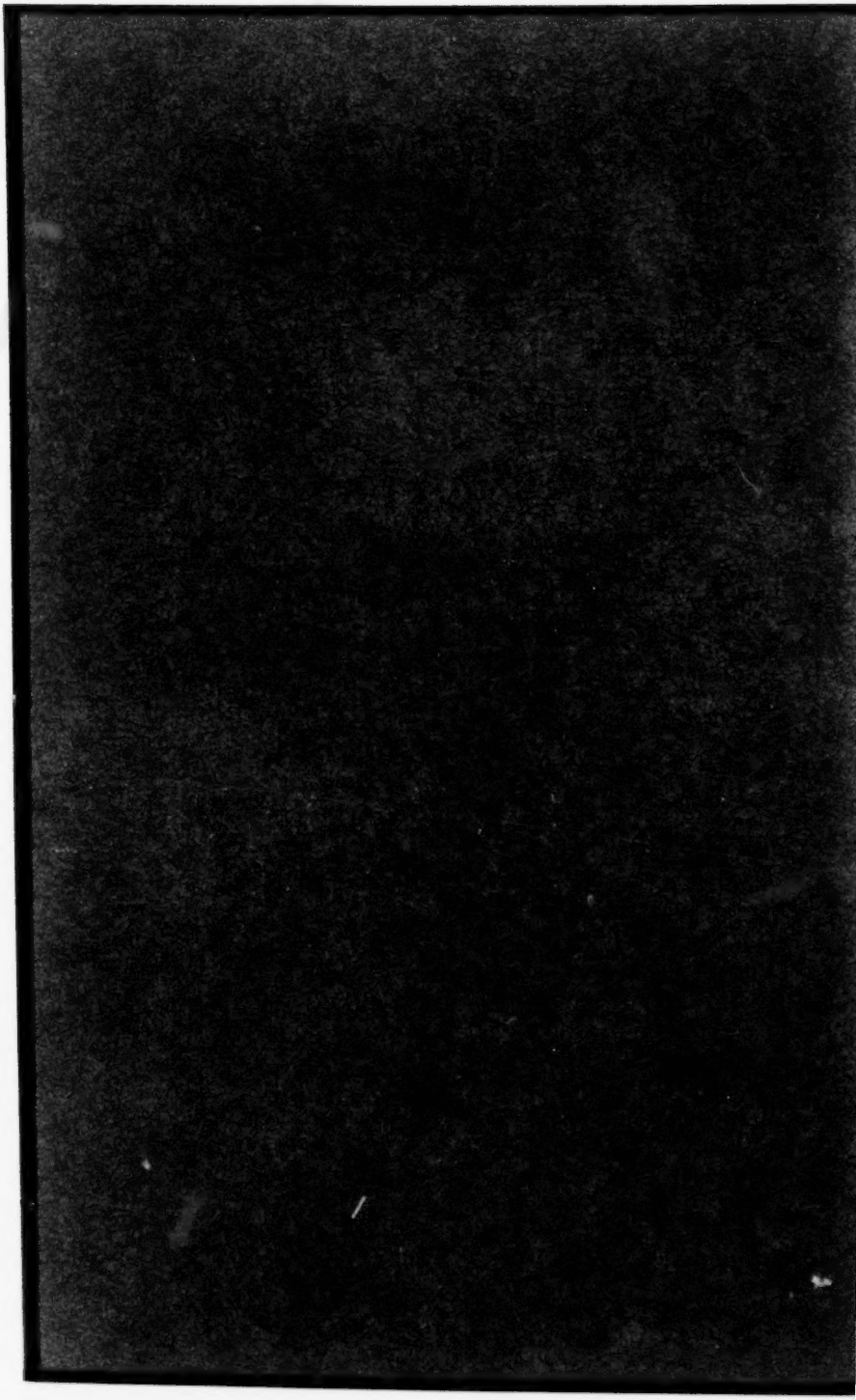
ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION



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In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 956

MRS. S. W. C. LUMPKIN, PETITIONER

v.

WM. P. BOWERS, COLLECTOR OF INTERNAL REVENUE FOR THE STATE OF SOUTH CAROLINA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the district court (R. 13–19) is reported in 50 F. Supp. 874. The opinion of the circuit court of appeals (R. 26–29) is reported in 140 F. 2d 927.

JURISDICTION

The judgment of the circuit court of appeals was entered on February 4, 1944 (R. 30). The petition for a writ of certiorari was filed on May 2, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Are attorneys' fees and other legal expenses incurred in the defense of title to corporate stock capital expenditures the cost of which must be added to the cost of the stock or are they deductible as nontrade or nonbusiness expenses under the retroactive provisions of Section 121 of the Revenue Act of 1942?

STATUTE AND REGULATIONS INVOLVED

The applicable statute and regulations are set out in Appendix A, *infra,* pp. 11–13.

STATEMENT

This is a suit against the Collector of Internal Revenue for the District of South Carolina to recover individual income taxes and interest alleged to have been overpaid for the years 1936 and 1937, in a total sum amounting, together with interest, to $22,680.10 (R. 19).

The petitioner was formerly the wife of H. D. Crosswell, who, with his brother, owned equally the entire 50 shares of stock of H. D. and J. K. Crosswell, Inc. The company owned valuable franchise rights respecting the sale and distribution of Coca-Cola syrup in various counties in South Carolina from which the company received commissions or royalties. (R. 14.)

H. D. Crosswell died in 1922 and by will left his 25 shares of stock in the Crosswell Company in trust to his wife for her life. She then became

a salaried officer of the company, which was operated by her and her brother-in-law, J. K. Crosswell. (R. 14–15.)

In 1929 J. K. Crosswell died and by will conveyed his 25 shares of stock in the Crosswell Company to trustees in trust to establish and maintain an orphanage. In 1930, the petitioner purchased from the trustees of the orphanage the 25 shares of stock of the Crosswell Company for a consideration of $255,885. (R. 15.)

In 1936, the Attorney General, on behalf of the State of South Carolina, instituted an action against the petitioner seeking to invalidate the sale of the stock and for an accounting. On appeal from an adverse decision the Supreme Court of South Carolina sustained the validity of the sale. (R. 15.)

In the defense of that litigation the petitioner incurred expenses of $250 in 1936 and $26,798.22 in 1937 for attorneys' fees and other expenses, which amounts she deducted from gross income reported in her federal income tax returns. The Commissioner of Internal Revenue disallowed the deductions and assessed additional taxes and interest of $19,342.72, which were paid under protest. A claim for refund of the taxes paid was filed and upon its rejection this action was instituted against the Collector. (R. 15–16.)

The District Court for the Eastern District of South Carolina held that the amounts expended were deductible as nontrade and nonbusiness ex-

penses under the retroactive provisions of Section 121 of the Revenue Act of 1942 (R. 16–19). Judgment was entered against the Collector for $22,680.10 (R. 19). The Circuit Court of Appeals for the Fourth Circuit held that the amounts expended were capital expenditures and were not deductible (R. 26–29). It reversed the judgment of the district court (R. 30).

ARGUMENT

There is no conflict of decisions on the issue here presented and none is pointed out by the petitioner. The principal basis of the petition is that the circuit court of appeals has misconstrued the applicable statute. We submit that such is not the case.

1. The attorneys' fees and expenses incurred in the instant case were in defense of title to stock which the taxpayer had purchased. Treasury Regulations for 25 years have consistently provided that such expenses are capital expenditures to be added to the cost of the property.[1] Those regulations, by the enactment of successive Rev-

[1] Article 293 of Regulations 45 (1919 Ed.) and 62 (1922 Ed.), promulgated under the Revenue Acts of 1918 and 1921; Article 292 of Regulations 65 and 69, promulgated under the Revenue Acts of 1924 and 1926; Article 282 of Regulations 74 and 77, promulgated under the Revenue Acts of 1928 and 1932; Article 24–2 of Regulations 94 and 101, promulgated under the Revenue Acts of 1936 and 1938; Section 19.24–2 of Regulations 103 (1940 Ed.), promulgated under the Internal Revenue Code.

enue Acts, have been approved by Congress and now have the force and effect of law.[2]

The decided cases unanimously support the regulations and hold that amounts expended in defense of title to property are capital expenditures to be added to the cost of the property and are not deductible as expenses.[3] Many necessary payments are charges upon capital and cannot be deducted. *Welch* v. *Helvering,* 290 U. S. 111, 113–114. This distinction is illustrated in *Helvering* v. *Winmill,* 305 U. S. 79, where brokerage commissions in purchasing securities were held chargeable to capital account.

2. The taxpayer claims that the expenditures are deductible as nontrade or nonbusiness expenses under the retroactive provisions of Section 121

[2] *Helvering* v. *Reynolds Co.*, 306 U. S. 110, 115; *Helvering* v. *Winmill*, 305 U. S. 79, 83; *United States* v. *Safety Car Heating Co.*, 297 U. S. 88, 95–96; *United States* v. *Dakota-Montana Oil Co.*, 288 U. S. 459, 466; *Murphy Oil Co.* v. *Burnet*, 287 U. S. 299, 307.

[3] *Barbour Coal Co.* v. *Commissioner*, 74 F. 2d 163, 164 (C. C. A. 10th), certiorari denied, 295 U. S. 731; *Jones' Estate* v. *Commissioner*, 127 F. 2d 231, 232 (C. C. A. 5th); *Blackwell Oil & Gas Co.* v. *Commissioner*, 60 F. 2d 257, 258 (C. C. A. 10th); *McDuffie* v. *United States*, 19 F. Supp. 239, 247 (C. Cls.); *Murphy Oil Co.* v. *Burnet*, 55 F. 2d 17, 26 (C. C. A. 9th), affirmed on another issue, 287 U. S. 299; *Croker* v. *Burnet*, 62 F. 2d 991, 992 (App. D. C.); *Brawner* v. *Burnet*, 63 F. 2d 129, 131 (App. D. C.); *Hutchings* v. *Burnet*, 58 F. 2d 514 (App. D. C.); *Farmer* v. *Commissioner*, 126 F. 2d 542, 544 (C. C. A. 10th); *Owens* v. *Commissioner*, 125 F. 2d 210, 213 (C. C. A. 10th), certiorari denied, 316 U. S. 704; *Vernor* v. *United States*, 23 F. Supp. 532, 534 (C. Cls.).

of the Revenue Act of 1942 (Appendix A, *infra*). This amendment resulted from the decision in *Higgins* v. *Commissioner,* 312 U. S. 212, denying a deduction for expenses incurred in connection with managing the taxpayer's investments because such management did not constitute a trade or business.

Section 121 of the Revenue Act of 1942 does not allow a deduction for capital expenditures but only for certain nontrade or nonbusiness expenses proximately connected with the production or collection of income or when incurred in the management, conservation, or maintenance of property held for the production of income. The purpose of the amendment and its limitations are shown by the legislative history. S. Rep. No. 1631, 77th Cong., 2d Sess., p. 88 (Appendix B, *infra*), states:

> A deduction under this section is subject, except for the requirement of being incurred in connection with a trade or business, to all the restrictions and limitations that apply in the case of the deduction under section 23 (a) (1) (A) of an expense paid or incurred in carrying on any trade or business.

See also H. Rep. No. 2333, 77th Cong., 2d Sess., p. 75.

Since Congress thus undertook to subject deductions under Section 121 to all the restrictions and limitations that apply under Section 23 (a) (1) (A) (except the requirement of being incurred in connection with a trade or business), it is apparent

that no fundamental change in existing law as to capital expenditures was intended. There is no merit in the petitioner's claim that to construe Section 121 as not permitting the deduction of capital expenditures is to restrict unduly the language of the statute, and thus to disregard various rules for the construction of statutes (Br. 5–7). The first rule for the construction of any statute is to ascertain the intent of Congress (*Harrison* v. *Northern Trust Co.*, 317 U. S. 476, 479), and the intent of Congress here is clear.

Section 121 merely creates an allowance for nontrade and nonbusiness expenses which had theretofore been held not to be available to them because not incurred in carrying on a trade or business. No new class of allowable deductions was created which would include capital expenditures and no change was made in the pre-existing law that capital expenditures are not deductible. In enacting the Revenue Act of 1942, Congress did not authorize a deduction of capital expenditures for those engaged in business. Certainly the language used in Section 121 was not designed to grant such a deduction to those not engaged in business. So radical a departure from established principles would require specific and unmistakable language.

The expenditures here were capital expenditures incurred in the defense of title to property. They were not expenses incurred in the produc-

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tion or collection of income or for the management, conservation, or maintenance of property held for the production of income as required by the statute. Capital expenditures fall in a different category. We cannot agree with the statement (Br. 15) that the "expenses bore a reasonable proximate relation to the conservation of property held for the production of income." Expenses incurred in the "conservation" of property would include such items as the wages of caretakers or the rent of a safe-deposit box for securities; they would not include capital expenditures and Congress had no intent that they should. The circuit court of appeals recognized that Section 121 broadened the scope of deductions but rightly held that it was not intended to include capital expenditures.

Section 19.23 (a)–15 of Treasury Regulations 103, as amended by T. D. 5196 (Appendix A, *infra*), interpreting Section 121, expressly excludes capital expenditures as a deductible item of nontrade or nonbusiness expense. It also provides that expenditures incurred in defending or perfecting title to property constitute a part of the cost of the property. The pertinent provisions are as follows:

> Capital expenditures * * * are not allowable as nontrade or nonbusiness expenses.
>
> * * * *

> Expenditures incurred in defending or perfecting title to property, in recovering property (other than investment property and amounts of income which, if and when recovered, must be included in income), or in developing or improving property, constitute a part of the cost of the property and are not deductible expenses.

Decisions of the Tax Court, construing Section 121, have consistently held that attorneys' fees paid for defending title to property are capital expenditures to be added to the cost of the property and may not be deducted as expenses. *Heller* v. *Commissioner,* 2 T. C. 371, 373–374, pending on appeal (C. C. A. 9th); *Willmott* v. *Commissioner,* 2 T. C. 321, 326; *Herbst* v. *Commissioner,* decided June 26, 1943 (par. 43,309); *Jacobs* v. *Commissioner,* decided April 13, 1943 (par. 43,171). Paragraph references are to 1943–1944 P–H Tax Court Memorandum Decisions Service, where the full text of memorandum opinions may be found.

Deductions from income are not a matter of right but of legislative grace. Their allowance does not depend on equitable considerations, but the taxpayer must show that the case falls clearly within the wording of the statute. *New Colonial Co.* v. *Helvering,* 292 U. S. 435, 440; *Deputy* v. *du Pont,* 308 U. S. 488, 493; *White* v. *United States,* 305 U. S. 281, 292. There is no such showing in the instant case.

CONCLUSION

The decision of the circuit court of appeals is correct. There is no conflict or necessity for further review by this Court. The petition should be denied.

Respectfully submitted.

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MAY 1944.